

Rating Action: Moody's downgrades ratings of three Sri Lankan banks; changes outlooks to stable from negative

20 Nov 2018

Singapore, November 20, 2018 -- Moody's Investors Service has downgraded the long-term local currency deposit and foreign currency issuer ratings of Bank of Ceylon (BOC), Hatton National Bank Ltd. (HNB) and Sampath Bank PLC (Sampath) to B2 from B1.

At the same time, Moody's has downgraded the long-term foreign currency deposit ratings of the same three banks to B3 from B2.

And, Moody's has affirmed the short-term local and foreign currency deposit ratings of the banks at NP.

Moody's has also downgraded the Baseline Credit Assessments (BCAs) and adjusted BCAs of the three banks to b2 from b1.

As a result, Moody's has downgraded the banks' long-term local and foreign currency Counterparty Risk Ratings (CRRs) to B1 from Ba3, and their long-term Counterparty Risk Assessments (CRAs) to B1(cr) from Ba3(cr).

In addition, Moody's has affirmed the banks' short-term CRR of NP and short-term CRA of NP(cr).

And, Moody's has revised the rating outlooks of the banks, where applicable, to stable from negative.

The rating actions follow the downgrade of Sri Lanka's sovereign rating to B2 from B1 on 20 November 2018, and the change in the sovereign's rating outlook to stable from negative on the same date. To reflect the deterioration in the operating environment, Moody's has also lowered Sri Lanka's Macro Profile to "Weak" from "Weak+". The rating action on Sri Lanka's sovereign rating is discussed in greater detail in Moody's press release dated 20 November 2018:

https://www.moody's.com/research/Moodys-downgrades-Sri-Lankas-ratings-to-B2-changes-outlook-to-PR_391459

RATINGS RATIONALE

WEAKENING OPERATING ENVIRONMENT WILL PUT PRESSURE ON BANK ASSET QUALITY AND PROFITABILITY

Moody's expects that the recent political and financial market developments in Sri Lanka will weigh on the country's already weak GDP growth. In addition, tightening external financial conditions and domestic political instability are resulting in capital outflow and placing increasing pressure on the exchange rate and foreign exchange reserves. The Sri Lankan rupee has depreciated about 13% over the past 12 months (9% over the last three months) to 176.7 to the US dollar as of 16 November 2018.

Moody's expects that, after years of strong credit growth, the weakening operating environment will have a negative impact on the banks' asset quality and profitability, as seen by the systemwide nonperforming loan ratio increasing to 3.6% as of August 2018 versus 2.5% in December 2017.

To reflect the deterioration in the operating environment, Moody's has lowered Sri Lanka's Macro Profile to "Weak" from "Weak+", which in turn led Moody's to downgrade the BCA and adjusted BCA of BOC and Sampath to b2 from b1. In the case of HNB, its BCA and adjusted BCA of b2 is constrained by Sri Lanka's sovereign rating.

DOWNGRADE OF LONG-TERM RATINGS

Moody's has kept the government support assumptions for the three Sri Lanka banks unchanged, driven by the systemic importance of these banks, as well as the government's record of supporting the banking system. Furthermore, Moody's believes that there is a high level of dependency between the creditworthiness of rated

Sri Lankan banks and the sovereign, because of the domestic nature of their operations and their significant direct and indirect exposures to domestic sovereign debt relative to their capital bases.

As a result, Moody's incorporates a very high level of government support in the ratings of BOC, given its 100% ownership by the government and dominant share of system loans and deposits. And, Moody's incorporates a high level of support in the ratings of HNB and Sampath, given their significant market shares of system loans and deposits.

Nevertheless, given that the adjusted BCA of these banks is already at the level of the sovereign rating, their long-term local currency deposit and foreign currency issuer ratings do not benefit from any uplift due to government support. At the same time, HNB's adjusted BCA and long-term deposit and issuer ratings are constrained by Sri Lanka's sovereign rating of B2, given HNB's significant exposure to the Sri Lankan government; a situation which is common in relation to other Sri Lankan banks.

The downgrade of the long-term foreign currency deposit ratings of the three Sri Lankan banks to B3 from B2 is driven by the lowering of the sovereign ceilings. In the sovereign rating action, Sri Lanka's foreign currency deposit ceiling was lowered to B3 from B2.

WHAT COULD MOVE THE RATING UP

An upgrade of the banks' long-term ratings is unlikely, because the ratings are already at the same level as the sovereign rating, and the sovereign rating outlook is stable.

WHAT COULD MOVE THE RATING DOWN

A downgrade of the sovereign rating would result in a downgrade of the banks' long-term ratings.

Nevertheless, Moody's could downgrade the banks' BCAs if there is a material deterioration in solvency factors, such as asset quality or capital. Increased reliance on market funding or a lower level of liquidity would also add downward pressure on their BCAs.

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Bank of Ceylon, headquartered in Colombo, reported total assets of LKR2,145 billion at 30 September 2018.

Sampath Bank PLC, headquartered in Colombo, reported total assets of LKR926 billion at 30 September 2018.

Hatton National Bank Ltd., headquartered in Colombo, reported total assets of LKR1,090 billion at 30 September 2018.

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Tengfu Li
Analyst
Financial Institutions Group
Moody's Investors Service Singapore Pte. Ltd.
50 Raffles Place #23-06
Singapore Land Tower
Singapore 48623
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Graeme Knowd
MD - Banking
Financial Institutions Group
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Releasing Office:
Moody's Investors Service Singapore Pte. Ltd.
50 Raffles Place #23-06
Singapore Land Tower
Singapore 48623
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

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